

Answers to TouchPlay Questions

posed by

Oversight Committees

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A. DESIGN OF TOUCHPLAY MACHINES

- A-1. You previously presented to this committee a prototype of a machine that dispensed pull tab tickets on every play with some video and sound. Why aren't those machines being used?

As the TouchPlay project was being developed, the Lottery was advised not to simply produce machines through the company providing the prototype, but to solicit proposals from a variety of companies, allowing them to bid to provide the technology that would be most effective and lowest cost. Four companies initially replied, including the company that produced the prototype. However, that company later withdrew its interest because of its own internal financial concerns, and the Lottery was left with the other three. The Lottery pursued a relationship with all these, deciding that the marketplace would determine which company provided the best product.

- A-2. When did you make the decision to use a machine that looks and plays like a slot machine? What was the reason for the decision? Will you please explain what authority you had to do so? Why didn't you re-present a prototype to the committee when you made the decision to use a machine that looks and plays like a slot machine?

All of the machines that were proposed to the Lottery have similarities to slot machines – some more than others. The Legislature allowed amusement devices that look and play like slot machines to be placed in lottery outlets, costing the state millions of dollars in lost pull-tab revenues. The Lottery's only alternative to capture those lost revenues was to use machines that looked and played more like amusement devices. All of the machines considered for use in the TouchPlay project met the requirements of both Chapter 99E and subsequent Chapter 99G. We made a presentation to the Rules Review Committee in 2002 and included an in-depth discussion regarding the similarities between monitor vending machines and slot machines. The committee did not object. It appeared that the issue had been sufficiently aired. We have continued to regularly report to legislative committees in the 3½ years since.

- A-3. Did legislators see an actual B7's machines and how it operates?

I do not believe so. See Appendix A-3.0 for a list of the 21 TouchPlay games that have been certified in the project to date. Blazing 7's is only one of them, and the company that produces it was the third to be certified by the lottery to sell machines in Iowa. By the time Blazing 7's TouchPlay machines began to be distributed in Iowa, there already were more than 1,000 similar machines from other companies in operation. The Lottery produces about 40 scratch ticket games per year, about 10 pull-tab games per year, and obviously a variety of TouchPlay games. Each requires Lottery Board approval. It turns out that Blazing 7's is also the name of a slot machine game, while none of the others are. We had asked the company that produces Blazing 7's if the game name or graphics had been marketed as a slot machine in Iowa. The answer we received was "no." We were misinformed.

We learned after the machines began to be delivered in Iowa that Blazing 7's was the name of a casino game. Although that was not our preference, it was not necessarily alarming, because there is a long list of game names shared by both the lottery business for scratch tickets and the casino business. See Appendix A-3.1 for those trademarks licensed to both the lottery and casino industries.

Also, lotteries have agreed to allow casinos to use the trade name Powerball® on a line of progressive slot machines to have the highest jackpots in the casino industry. Under that agreement the casinos cannot market the Powerball name or logo outside of a casino, so that there won't be confusion between playing our Powerball lottery game and playing Powerball slot machines. With regard to Blazing 7's, the Lottery has not advertised any TouchPlay game on radio or television or in print so there would be little confusion.

- A-4. Do you think the legislature would have given you the authority to put a machine that looks like a slot machine in grocery stores, restaurants, etc. if you would have presented it to this committee initially?

We didn't question it because of previous action already taken by the Legislature. Amusement devices look and play like slot machines. Amusement devices also contain and use an internal randomizer like a slot machine. The Legislature had authorized the use of amusement devices in Iowa and they had been placed in bars, restaurants, and c-stores. There had been no public or legislative dissent with regard to the similarity of these machines and slot machines, yet the amusement devices were largely unregulated. It seemed logical that the Legislature would be pleased if the Lottery introduced to the marketplace comparable-looking machines that were highly controlled and regulated for accounting, security, and criminal background purposes while at the same time creating a new revenue stream for the state. To produce a machine with comparable looks and performance and with greater operational integrity with the potential to replace the other devices would seem to be a public good.

- A-5. Do you think that people would sit for hours to play a pull-tab dispensing machine such as the design you originally discussed with legislative leaders?

The Lottery strives to produce entertaining products and like all other businesses has made efforts to in move from paper products to electronic products in order to keep up with the times. However, the Lottery would hope that no one would play any of its products for hours if they can't afford it. Unlike a casino, it is not the Lottery's intent to capture as much money as possible from any individual upon every contact with a gaming product.

- A-6. Who first asked you to develop TouchPlay? The governor? William Krause?

In 2001, members of the Administration and Regulation Appropriations Subcommittee requested that the Lottery look for new sources of revenue that would not require a change in the statute in order to help balance the budget. A number of new ideas were developed over the following summer, with monitor vending machines (TouchPlay) being among them.

- A-7. When did you or your staff first discover TouchPlay?

The Lottery was aware of similar devices being operated legally on Indian reservations and in bingo halls in states where casino gambling and slot machines were illegal. The Lottery worked with a company to develop a prototype that would comply with Iowa law in early 2002.

A-8. When did you or your staff first contact Bally Gaming?

We did not contact Bally. Through articles on TouchPlay in trade publications, Bally Gaming Systems became aware that the Iowa Lottery was conducting tests for monitor vending machines in 2004. Bally Gaming, which makes central determinant machines like TouchPlay for the New York Lottery, made contact with the Iowa Lottery.

A-9. When did your or your staff first contact Oasis?

The Lottery did not contact Oasis. The Lottery issued a request for information from any interested companies and posted it on the Lottery Web site in 2002. Oasis responded.

A-10. For one dollar spent on a TouchPlay machine, what are the chances of winning one dollar?

91.96 percent on average.

A-11. Are the chances of winning on one TouchPlay machine any better than winning on another?

There are more than 20 different TouchPlay games. The chances of winning money vary from game to game, but are exactly the same for any particular game regardless of machine or location. That is unlike slot machines, where each individual device, even those offering the same game, can be programmed to have a different payout percentage.

A-12. What is the payout percentage of TouchPlay machines?

91.96 percent using the casino method. About 65 percent of money put into a TouchPlay machine is paid out in prizes. That would be similar for a casino slot machine, but casinos don't publish or advertise that payout calculation.

A-13. Did you advise legislators of the difference between predetermined and random payouts?

Yes. On many occasions, including at least two Oversight meetings, a Rules Review Committee meeting, and an Administration-Regulation Appropriations Subcommittee meeting, significant time was spent distinguishing TouchPlay machines from amusement devices and slot machines.

A-14. From the standpoint of the customer, what difference is the difference between a casino slot machine and a TouchPlay machine?

With slot machines the odds can vary within an individual game even on slot machines with the same game standing side by side. With TouchPlay the odds do not vary by game. Consumers play against other consumers. A finite pool of winners and losers is preprogrammed and doled out in a specified order. As prizes are won they are removed from the prize pool and are not available to anyone else. With slot machines, payouts can

be adjusted by machine. With TouchPlay, the payouts have nothing to do with the machine and remain consistent within the game played, no matter which machine or location is involved.

- A-15. You have been quoted as agreeing that the majority of the consuming public probably thinks that TouchPlay machines are slot machines. Is that correct?

I believe I have said that a majority of the consuming public probably thinks that TouchPlay machines look like slot machines.

- A-16. What is your interest in the patent or copyrights on TouchPlay machines? How did you come about acquiring this interest? Why haven't you assigned all your rights in the patent to the State? What other patents do you have any interest in?

Neither I nor any other employee of the Iowa Lottery has any interest in any patent or copyrights on TouchPlay machines. I am the inventor of a few non-TouchPlay lottery games and have assigned all rights to the Iowa Lottery and the Multi-State Lottery Association. These patents involve lottery games that might be considered a potential successor to Powerball. I was recently awarded a patent in Europe and intend to assign that license also.

- A-17. What is the relationship between the lottery and William Krause's company Royal Financial and Terry Moss' Company?

Royal Financial is licensed by the Lottery as a monitor vending machine retailer. Moss Distributing is licensed by the Lottery as a monitor vending machine retailer and is a distributor in the program.

- A-18. Why do Touch Play machines pay out less than slots at a casino?

TouchPlay machines are not slot machines. Also, see the answers to A-10 and A-12.

B. REVENUE OF TOUCHPLAY AND OTHER LOTTERY GAMES

- B-1. Define the terms of this business? What constitutes is a distributor? What constitutes an operator? What is considered a location?

A distributor is a company that purchases TouchPlay machines from a manufacturer and then resells or leases them to retailers/operators. An operator, sometimes called a retailer-operator, is a licensed purchaser or lessee of a TouchPlay machine. A premises is the location at which a TouchPlay machine is licensed to operate.

- B-2. How much of each dollar in revenue from a TouchPlay machine goes to the State General Fund?

The lottery receives the following share of the net revenue from the TouchPlay project: 24 percent for 2006, 27 percent for 2007, 30 percent for 2008, and 34 percent for 2009. One half of one percent of TouchPlay revenues go to the State Gambling Treatment Program with the balance going to the state General Fund. A portion of the revenues

shared by the manufacturers, retailer-operators, premises and distributors are also paid to the state General Fund in the form of income taxes.

- B-3. Where does the remainder of each dollar in revenue go? How much is that estimated as being for FY 2006 and FY 2007? **B-4.** How much of each dollar in revenue from a TouchPlay machine goes to the retailer? **B-5.** How much of each dollar in revenue from a TouchPlay machine goes to the distributor? **B-6.** How much of each dollar in revenue from a TouchPlay machine goes to the operator? **B-7.** How much of each dollar in revenue from a TouchPlay machine goes to the manufacturer?

The remainder is split among the manufacturer, retailer, and premise owner according to private agreements negotiated among them. These funds are used to pay for capital costs of the machines or their rental or lease, their maintenance, repair, placement, communications lines to the central system, the operation of the central system, space rental, and other costs associated with operating the various businesses. The estimate is \$95 million for FY 2006 and \$131 million for FY 2007.

- B-8. What was explained to legislators about financing and the split of the total money generated? And when?

The split was explained in the Lottery's June 24, 2004, report to the Oversight Committees. The split was refined later in the year by the Lottery Board and reported again to the Oversight Committees in August 2005 and again in December 2005.

- B-9. Does the Lottery review and approve the contracts between manufacturers, distributors, operators, and retailers like the Iowa Racing and Gaming Commission approves the casinos contracts? If not, why not? Or does the Director negotiate and approve contracts?

The Lottery negotiates and the Lottery Board approves the contracts between the Lottery and TouchPlay manufacturers. The Lottery does not review or approve the private-sector contracts among the manufacturers, distributors, operators, and retailers regarding their own negotiated price of equipment or financial terms. The Lottery's contracts with distributors, operators, and retailers are in the form of licenses stipulating the terms and conditions under which the licenses are valid. (See Appendix B-9.0, B-9.1 and B.9.2)

- B-10. Who are the manufacturers and distributors? How many are Iowa companies?

The manufacturers are: Oasis Gaming, Omaha, Neb.; Diamond Game Enterprises Inc., Chatsworth, Calif.; Bally Gaming Systems, Las Vegas, Nev.; and Multimedia Games, Austin, Texas. Bally, Diamond, and Multimedia have established offices in Iowa. The distributors are: Moss Distributing, Des Moines, Iowa; Greater America Distributing, Johnston, Iowa; Central Distributing, Omaha, Neb.; and Redline Vending, Charles City, Iowa.

- B-11. Who authorized the 24% rate of revenue that goes to the State and why doesn't the State receive a higher percentage?

Casinos are taxed at a 22% rate. The Lottery Board established a 24% rate through

calendar year 2006. The rate goes to 27% in 2007, 30% in 2008 and 34% in 2009.

- B-12. How much of each dollar in revenue from Powerball goes to the State General Fund?

Approximately 33%.

- B-13. How much of each dollar in revenue from Lotto goes to the State General Fund?

Approximately 31%.

- B-14. How much of each dollar in revenue from pull-tab tickets goes to the State General Fund?

Approximately 21%.

- B-15. How much of each dollar in revenue from instant-win tickets goes to the State General Fund?

Approximately 20%.

- B-16. Why doesn't the State get the same percentage of revenue from TouchPlay games that it gets from other Lottery products?

Each lottery product has a different payout gauged to optimize performance of that product through market research and experience. Therefore, payouts in various games are adjusted to optimize net return to the state. In addition, private companies made the capital investment in the TouchPlay project and are receiving a share of the net revenue.

- B-17. Why isn't the exact monthly revenue as well as number of machines at each location posted on the Lottery website for public review like revenue and number of slot machines for each casino is posted on the Iowa Racing and Gaming Commission's website? Will you provide that information for the past six months to the Committee?

Although the Racing and Gaming Commission posts monthly figures for the numbers of machines at each of its 13 regulated locations, it does not post the revenue figures for each of the 13,000 slot machines. It would be very cumbersome, and perhaps a meaningless exercise, for them to do so. The same would apply for the Lottery posting comparable numbers for its several thousand retail locations. Such information can be provided upon request. However, the information must be provided according to the Lottery's accounting conventions and is tabulated on a weekly basis. The Lottery would be happy to provide this information, however you must clarify whether you want the data displayed on a weekly basis for each of the past 26 weeks or an aggregate for the past 26 weeks.

- B-18. What is your interest in the patent or copyrights on TouchPlay machines? How did you come about acquiring this interest? Why haven't you assigned all your rights in the patent to the State? What other patents do you have any interest in?

None. See A-16.

- B-19. What is the relationship between the lottery and William Krause's company Royal Financial and Terry Moss's company?

See A-17.

- B-20. Why do TouchPlay machines pay out less than slots at a casino?

See A-18.

- B-21. What specific fees do each of the levels of participants in this process (manufacturers – premises/locations) pay to the lottery? Do they each have to pay the full cost of the certification process, and what are those costs?

Manufacturers pay the cost of DCI criminal background investigations, which start at \$25,000 and go up, depending on the complexity of the company. The other levels of participants pay a \$25 license fee. The Lottery has its own laboratory that certifies all TouchPlay products. The manufacturers are not asked to pay those costs so that the Lottery can maintain its independence and not be influenced by the size of those fees.

C. PROLIFERATION OF GAMBLING

- C-1. Why are TouchPlay machines being placed in locations that don't offer other lottery products? (i.e. tanning, beauty salons, laundromats, hardware stores, etc?)

Barbershops, laundromats, hardware stores, etc., have and do carry other lottery products. They apply for lottery licenses. However, as of November 2005, TouchPlay licenses are only being issued to convenience stores, gas stations, truck stops, grocery stores, drug stores, liquor stores, bars, restaurants serving alcohol, bowling alleys, and fraternal organizations, as these businesses are best situated to serve the public convenience.

- C-2. How is the Lottery justified in placing TouchPlay machines, which are indistinguishable from slot machines from the consumer's standpoint, in counties that have voted down casino gambling?

Although TouchPlay machines resemble slot machines, they provide electronic equivalents of pull-tab or scratch tickets. The Lottery does not allow several hundred or several thousand TouchPlay machines in any one location like a casino would place slot machines. The Lottery has sold its products in all 99 counties since 1985 -- before there were any casinos in Iowa. None of the lottery licensees are businesses solely providing gambling products. Casino gambling involves an intense environment with tens of thousands of square feet devoted exclusively to gambling. The TouchPlay environment with one to four machines per location is very different from thousands of square feet of concentrated casino gambling involving slots and table games.

- C-3. Do you agree that concern over the proliferation of gambling machines is a legitimate policy concern of the General Assembly?

Yes.

C-4. How are TouchPlay machines marketed?

The Lottery has never produced or placed any radio, television, or newspaper advertising for TouchPlay. If any such advertising has appeared, it was arranged and paid for by the private-sector companies participating in the project.

C-5. Why was the May 23, 2005 moratorium imposed?

The Lottery determined that the number of manufacturers and retailer operators was sufficient to satisfy the public convenience.

C-6. Does the Lottery have any studies or statistics on how TouchPlay machines are affecting the problem of compulsive gambling?

Throughout the three-year history of the machines' deployment in Iowa, the Lottery has requested information from the Gamblers' Treatment Program housed at the Iowa Department of Public Health. Through late 2005 there were no reports of compulsive gambling referrals associated with TouchPlay. However, anecdotal information in the last two months suggests that there may be some TouchPlay involvement with compulsive gambling. Reports continue to indicate that 81% of problem gambling in Iowa is related to casinos and 5% is related to the lottery; basically unchanged from prior years. Recent literature indicates that one factor in compulsive gambling is "ambiance." This is defined as the intense gambling environment that is found in gambling destinations such as casinos and is absent at licensed lottery retailers.

C-7. Why doesn't the Lottery have a self-exclusion program for TouchPlay machines like the casinos do?

The Lottery does have a self-exclusion program passed by the Lottery Board in December 2005. For a sample contract, see Appendix C-7.

C-8. Please provide a copy of your business plan(s) for development/deployment of Touch Play machines.

See Appendix C-8.

C-9. Have you requested an opinion from the AG that the law does allow deployment of TouchPlay machines.

From its inception the TouchPlay program has been guided by the advice of two Assistant Attorneys General. During the development of TouchPlay an Assistant Attorney General was assigned full-time to the Lottery.

C-10. How would the Lottery address removing Touch Play machines if the General Assembly changes the Code of Iowa to require their removal? **C-11.** How would the Lottery address removing Touch Play machines from all convenient and other grocery stores if this is mandated by the General Assembly?

Placing the machines has taken three years. Removing them would be an extraordinary administrative task requiring significant planning and perhaps financing, dependent upon

the nature of any legislation enacted. The Lottery does not own or lease any TouchPlay equipment, so any removal must take into account ownership rights and legal issues regarding the confiscation of private property.

C-12. Is the Lottery considering the possibility of public playing Touch Play on the Internet?

No.

C-13. Are traditional lottery machines located in adult cinemas establishments? How many Touch Play machines are located in adult cinema locations?

A very small number of adult dance clubs that have tobacco and liquor licenses from the state may also have a lottery license. One adult cinema, which has a state sales tax permit and is an age-restricted venue, has TouchPlay machines. Because it is a legal business that provides age restrictions, the Lottery was at a loss as to grounds for a license denial.

C-14. Are you intending to enforce your own rules?

Yes.

C-15. When did the T.P. deploy to grocery stores?

TouchPlay machines first were deployed in locations other than bars and taverns during the convenience store test that began in September 2004. However, there were few in grocery stores until mid-2005 when the grocers in increasing numbers applied for licenses.

C-16. December 2005, you noted the 4,500 machines were located in 2,500 locations. When did you know this amount was going to occur? Why wasn't that reported to Oversight beforehand?

The Lottery made the projection that it could raise \$20 million of new revenue for the state, based on a projected deployment of 4,000 machines statewide, in its semi-annual report on operations made to the Oversight Committees dated November 19, 2003. Another copy of that report was provided to the Oversight Committee at its last meeting for the presentation on historical development. The 4,000 figure was based on estimates at the time of amusement device numbers, which later proved to be much higher.

C-17. Have the proposal for rules for age restricted environment meaning when younger than 21 are not allowed; location may have 4 machines been approved

The Lottery has appeared before the Rules Review Committee about this particular rule in January and has held a public hearing. It is expected that the Lottery Board would take final action on this rule at its next meeting.

C-18. How can you say plastic strap or 3 foot from grocery checkout counters are age restricted?

The age-restricted areas are required for three or four TouchPlay machines but have not been required for locations with one or two machines. This policy is under review, as is the adequacy of barriers employed by retailers to cordon off age-restricted areas.

- C-19. In November 2003, your staff recommended a cap of 2 machines/location. Who authorized more?

Limits on the number of machines that can be placed are set by the Lottery Board. The current limit is no more than two per location unless the location is restricted to those over 21, a fraternal organization, or has an age-restricted area within the store, in which case the limit is four.

- C-20. What has been the effect on traditional pull-tab sales?

Traditional pull-tab sales declined by 10% the first year that amusement devices were placed in C-stores and down 11% the next. With the introduction of TouchPlay, traditional pull-tab profits are down about another \$600,000 per year.

- C-21. How can you say placing these machines in grocery and c-stores is "preserving the dignity of the State?"

Lottery products have been sold in almost all grocery stores and c-stores since 1985. In addition, TouchPlay machines, which are highly regulated, have replaced the loosely regulated amusement devices that once operated there.

- C-22. Regarding comments about minutes of Oversight 2004 Session showing "we asked Lottery to work things out with amusement operators to c-stores? What were results - consider common locations or expand locations for more competition? How can that request be considered as direction from the committee since there was no formal action taken?"

The Lottery had explained to the Oversight Committees that amusement devices being placed in convenience stores had caused double-digit declines in lottery pull-tab sales. The Legislature decided to require registration of amusement devices but did not require their removal from convenience stores. The amusement devices are slot machine-like devices that look and operate like slot machines and are loosely regulated. The Lottery proposed an alternative that would be highly regulated. Unlike the amusement devices, the Lottery program would be subject to criminal background investigations, full accounting, certification of games to ensure that the public receives what is being promised, and communication lines to central systems for every device to monitor money going into the machines and prizes paid. In November 2004 the Lottery reported to the Oversight Committees that it had placed 20 machines in C-stores for a test and would proceed if the test was successful. No comments were made at the meeting suggesting that the Lottery not proceed and no action was taken by the committees to deter the Lottery from the legislative charge passed in 2002.

- C-23. Who drafted these contracts? Who were the attorneys? Who negotiated these contracts? Were they approved by the Lottery Commission?

All contracts related to TouchPlay were drafted by in-house lawyers, then reviewed and approved by Assistant Attorneys General and the Lottery Board.

- C-24. When and where were the first meetings on TouchPlay with the convenience stores and grocery stores and who was involved?

The first contact was with Jan Johnson, the Executive Director of the IOMA on July 23, 2004 (see Appendix C-24.0 and C-24.1). The amusement operators were asked to choose C-store participants. They were contacted in August 2004 and are listed in Appendix C-24.2.

D. INVESTMENTS AND COST OF TOUCHPLAY

- D-1. How did you determine that \$100 million dollars has been invested in TouchPlay machines?

The estimate of \$100 million of investment was made by the TouchPlay Coalition. We believe the estimate is reasonable, based on orders placed for 10,500 machines at a cost of \$7,000 to \$10,000 per machine plus the costs of the central system, communications lines, equipment, employees, operations, and maintenance provided by those businesses.

- D-2. What portion of the investment has been made by manufactures? Distributors? Operators? Retailers? The Lottery?

The Lottery investment is minimal and pertains mostly to additional staff for monitoring, policing, and testing. The balance of the investment has been made by the manufacturers, distributors, operators and retailers; however, the split among those entities is governed by their private contracts. Because there would be so many contracts involving the financing and those might be later subject to dispute, the Lottery decided that it would be better not to be a party to those contracts in order to avoid being needlessly infused in potential litigation if disagreements later developed among the private sector parties.

- D-3. How many machines have been purchased, and by whom?

Some machines are purchased, some may be leased or under lease-purchase agreements. The specific arrangements are as per the answer to question D-2. The Lottery can only tell you how many machines are operating among each of the 90 licensed MVM operator/retailers or how many machines are at each retail premise.

- D-4. What expenses have retail locations incurred?

Retail locations have incurred expenses related to communications and electric lines as well as the construction of age-restricted areas.

- D-5. How many retailers have purchased TouchPlay machines as opposed to renting them?

See the answer to D-2.

- D-6. How many machines have earned enough revenue to cover the cost of the machine?

See the answer to D-2. The Lottery is not privy to the private contracts and has no way to determine an answer to this question. The Lottery does not have access to corporate tax returns for machine owners or lessees.

- D-7. How much do the TouchPlay machines cost to manufacture? Purchase from a manufacturer? Purchase from an operator? Rent from an operator?

The cost of manufacturing TouchPlay machines is a trade secret that would have to be released by the companies that manufacture them. Purchase prices or lease or rental agreements are negotiated as explained in the answer to question D-2.

- D-8. Have any retailers had to expand or remodel to place TouchPlay machines?

Some locations have remodeled or reworked their retail sales spaces in order to offer TouchPlay machines, but the Lottery does not require tabulations on increases in floor space or remodeling statistics from private businesses.

- D-9. Have any new local jobs been created by the placement of TouchPlay machines?

Positions for technicians, installers, office staff, and some manufacturing jobs to make parts for TouchPlay machines have been created throughout Iowa.

- D-10. It has been widely reported that there are over 2600 "mom and pop" businesses that need this revenue from TouchPlay machines to stay in business. Why didn't we hear of a major crisis of business closures looming last Spring before any of these places had any machines?

This question has to be placed to those businesses. We have been told that many small businesses have been negatively affected by high fuel and utility costs. Most of the increases in costs have occurred as a result of international events involving oil exporters and exacerbated by natural disasters, including hurricanes that hit the Gulf Coast in the summer and fall. There are also more high-volume corporate sellers (like superstores) of discount gasoline. The mom-and-pops may have to sell gasoline below cost to get any traffic. TouchPlay helps make up for the loss on fuel sales.

- D-11. It has been widely reported that there are millions of dollars invested by these "mom and pop" locations. Aren't hundreds of these locations owned by corporations such as HyVee, Dahl's, and Kum & Go? How many machines do each of them have?

Hy Vee has 140 machines, Dahl's has 30 Machines, Kum & Go has 456 machines.

- D-12. Is it true that Moss Distributing owns the Bally's machines that get placed and Bill Krause with Royal Financial owns the Oasis machines that get placed?

Moss Distributing buys both Bally and Diamond machines and resells them or leases them to Iowa businesses. Royal Financial owns the Oasis machines that it places, but does not own the Oasis machines that are placed by other Iowa businesses.

- D-13. Private industry stands to make \$65 million from the TouchPlay machines. Who's making this money? Who are the largest moneymakers?

Private businesses stand to receive about \$95 million in revenues in 2006 and about \$131 million in revenues in 2007. This money is split according to the answers given in question D-2. The least expense and therefore greatest profitability would be with the

several thousand retail locations across the state. Since the Lottery is not privy to business income tax returns, it can't answer the question any further.

- D-14. Where the money came from for the Lottery to purchase any Touch play equipment before any revenues from the machines were received. Such as during the pilot project? Were there any private corporations or citizens involved in providing money to the authority to purchase equipment.

The Lottery has never purchased any TouchPlay equipment. Test machines were provided for the Lottery's use by their manufacturers. During the tests the Lottery negotiated the payment of maintenance and paper costs to be paid to the manufacturers. No private corporation or citizen provided any money to the Authority to purchase equipment.

E. SECURITY AND UNDERAGE GAMBLING

- E-1 There have been several reported recent break-ins during which thieves tried to access the money TouchPlay machines. The Chuck Wagon Café in Cumberland, and several in that area; the Earlham café; the Filling Station, Wellman's just to name a few. Are you concerned that TouchPlay machines will cause an increase in crime and hold ups at these small locations?

There has been an increase in burglaries and robberies in stores statewide. TouchPlay machines have been one of the victims. Our investigators tell us that the change in the law last year making it harder to get cheap volumes of non-prescription drugs to make methamphetamine has caused the law-breakers to steal more cash to get the more expensive ingredients for meth. Nationwide, about 16 percent of reported crimes result in arrests. The Lottery's investigative unit, working with local law enforcement and the DCI, has solved more than 80 percent of the cases it has handled. It may be that the investigation of thefts from lottery machines will result in more meth-related arrests and convictions.

- E-2. What security measures have you taken to prevent someone from hacking into or otherwise defrauding the central system of the TouchPlay machines?

The Lottery specifies security measures and accounting measures in its certification criteria (see Appendix E-2.0). The software and hardware of each manufacturer is extensively tested in the Lottery laboratory according to the document provided in Appendix E-2.1. The Lottery's Chief Financial Officer, who has had experience in electronic data processing auditing, visits each central site to review it in detail. The laboratory testing takes a minimum of four to six weeks. An SAS 70 audit is required in the first year for each of the four central systems. An additional SAS 70 audit is required annually for each central system to ensure that what is in operation is what the lottery certified.

- E-3. Why aren't retailers required to monitor TouchPlay machines by video like the casinos are required to monitor slot machines?

Casinos have up to 66,000 square feet of gaming floor space to monitor. For TouchPlay,

the maximum of four machines occupies approximately 60 square feet. The machines are required to be within the line of sight of personnel on the premise where they are located. Video cameras are employed for security purposes in the majority of c-stores.

One of the reasons for video surveillance in casinos is to ensure that casino employees do not cheat patrons and that patrons do not cheat the house. Card handlers and table game equipment operators have an opportunity to use sleight of hand to alter the results of a game. All casino machines are stand-alone units. Someone with access to the gaming control unit inside a slot machine can alter the outcome. There is no internal randomizer in TouchPlay machines. All results are predetermined at a different time and location and merely sequenced to the TouchPlay device, just as pull-tab and scratch tickets are delivered to a retail location in a predetermined order. Therefore, access by retailer-operators or premises employees to the internal workings of the machines cannot alter the play results. Furthermore, sleight of hand cannot alter the results for TouchPlay.

- E-4. Why haven't you revoked the licenses of the retailer who have permitted underage people to play TouchPlay machines or have failed to ID users of TouchPlay machines? What sanctions have been taken against these retailers?

Casino licenses are not revoked or suspended for underage play. A fine of \$1,000 to \$10,000 that represents a few minutes of casino income is imposed instead. The Lottery's penalty for underage play on a first offense is a one-week suspension of a license. On a second offence it is a 30-day suspension, and on a third offense a one-year suspension. Despite all the rhetoric and second-hand and anecdotal information bandied about, there have been only two documented cases involving someone underage playing a TouchPlay machine. Notices for suspension of those licenses have been issued but are still within the required period to allow an appeal for a contested case hearing. Two other TouchPlay incidents with alleged underage play are currently under investigation.

- E-5. In the January 6th Administrative Rules Committee Meeting, a gambling treatment counselor stated her staff had witnessed a young child sitting in a grocery cart while the man played a TouchPlay machine. Are you concerned that young children have access to and are being exposed to gambling?

Although we know that children in grocery carts also pass by beer, liquor and cigarette displays in grocery and convenience stores, we do have concern about exposing children unnecessarily to TouchPlay. We are investigating mechanisms to further isolate TouchPlay machines from children and other members of the public who don't want to be bothered by them. Meanwhile, casinos promote family nights, arcades and other events designed to deliberately bring underage people to a gambling facility.

- E-6. Has the Lottery performed any investigations or asked the DCI to perform any investigations to determine which retailers are permitting underage customer to play their machines or are failing to ID players?

Two alleged incidents are under investigation by the DCI. In addition, three DCI agents are under contract to assist the Lottery in enforcing Chapter 99G. Every alleged incident of under-age play reported to the lottery is investigated by lottery investigators and harsh action is taken when a violation is found.

- E-7. It was also stated in the January 6th Administrative Rules Committee, that there are locations where the machines are behind double doors and not in clear view of the counter. What sanctions have you placed on those places?

In those locations, staffers have clear view of the entryway/doorway into the room, which is the only way to access the machines. In the Indianola location referenced during the committee meeting, the entryway to the room containing the machines is in clear view and control of the retail clerk. Furthermore, a video surveillance system is employed to monitor the interior of the room and the monitor is placed next to the clerk, not behind the clerk as reported at the meeting. The store has also relocated a beverage dispenser and placed an opening in the former dispenser location to ensure even greater visibility.

- E-8. Please you provide a list of which retailers have had their licenses suspended or revoked, or have been sanctioned or disciplined in any way, the reason for the discipline, and the discipline that was imposed.

See Appendix E-8.

- E-9. Why aren't retailers with less than two machines required to have a designated roped-off area for over 21?

In establishing the program, the Lottery envisioned that one or two machines in line of sight of a retail clerk would not pose a significant supervision challenge. The Legislature has allowed the placement of up to two slot-like amusement devices without any placement or supervision requirements. The Lottery believed that a more restrictive environment would be necessary for three or four of its machines and imposed a standard higher than that imposed by the Legislature on amusement devices. Three or four machines in a location would pose a greater challenge and therefore were confined to roped-off areas. However, it was not envisioned that parents would take children up to any of these machines whether roped off or not, but a few have. The machines in areas that are not roped off have greater visibility to the general public, including those who do not intend to use the machines. Therefore, the Lottery now believes it would be reasonable to consider placing all machines in restricted areas unless they are located in bars and taverns. That would prevent parents from legally taking children up to a TouchPlay machine.

- E-10. What are the standards for granting a retailer a TouchPlay license?

A retailer must undergo a criminal background investigation and a financial review. The background investigation is done by the DCI. A licensee must not have been convicted of a fraud, felony, or any gambling violation and must meet and agree to the terms and conditions in Appendix B-9.0.

- E-11. The Petroleum Marketers and Convenience Stores of Iowa who are joined with the Lottery in the TouchPlay Coalition; issued the following directive to their members:

"Take the extra steps to be vigilant in preventing youth access to TouchPlay. Even though the law does not require this for two machines, put a nice white

plastic fence up around your games. Put signage up that warns players they must be 21 to access. No kids, no matter what age, should even touch the machines. Be sure your employees are not playing! Be sure your employees are checking ID's. Don't be naïve."

Does this mean there have been problems with minors playing and kids near the machines to have this request suddenly put out? Why weren't there adequate regulations put in place before there was an aggressive effort to put thousands of the machines in place?

The Iowa Lottery is not a member of the TouchPlay Coalition. Millions of dollars are played through TouchPlay machines on a weekly basis. See the answer to E-8 above. The Lottery applauds any aggressive action on the part of lottery retailers to emphasize and re-emphasize how important it is to always enforce the rules. A weekly or daily reminder would be fine with us.

F. REGULATION OF TOUCHPLAY

- F-1. What contacts, advice and instructions have you had with the TouchPlay coalition?

The Lottery is not a member of the TouchPlay Coalition. Lottery representatives have been invited to a number of Coalition meetings to update them on the licensing terms and conditions, technological developments, financial reports, the general status of the project, and pending rules and legislation. The Lottery has avoided the business portion of Coalition meetings and has imposed some requirements not popular with Coalition members.

- F-2. When Lottery Staff is standing with representatives of the TouchPlay Coalition at press conferences and actively lobbying for the proliferation of the machines, how can you also serve as an effective regulator?

The Lottery is not a member of the TouchPlay Coalition and has never attended one of its press conferences. The Lottery has never attended any press conferences organized by legislators. And, the Lottery has never held any press conferences with regard to TouchPlay. The Lottery has not requested any legislation relative to the TouchPlay project since 2002.

- F-3. Under current Iowa law, there are at least three governmental entities regulating different aspects of the gaming industry; the Racing and Gaming Commission, the Department of Inspections and Appeals, and the Lottery Authority. Isn't it time that the General Assembly should consider putting all gaming under the authority of one agency? If not, why not? If so, which of the existing agencies is best prepared to take jurisdiction?

Federal law requires that a lottery operate as a state-owned business. The entities regulated by the Racing and Gaming Commission view themselves as interests competing with the Lottery. Any individual state body making decisions where the

interests of one are pitted against the other would undoubtedly be placed in a position of either having a conflict of interest or the appearance of a conflict of interest. In a pervious administration, Governor Branstad asked if there should be a reorganization of all gaming entities under one roof with me as the executive director. Such reorganization had taken place in two other states and was quickly reversed after the arrangement proved to be unworkable. I advised Governor Branstad that such organization would not be good policy and the proposal was abandoned.

G. A Member requested copies of any letters, memos, or other materials used to solicit or encourage potential investors to invest in the TouchPlay machines.

The Lottery has never directly solicited investment in the TouchPlay program. We made the opportunity to participate available. The Lottery issued a statement of certification criteria. The latest version is in Appendix E-2.0. Any company meeting the criteria would be allowed to submit equipment and software for Lottery laboratory testing and certification. Upon certification the manufacturers would assist the Lottery TouchPlay program by soliciting business investment from retailer operators and the retailer operators in turn would solicit contracts for the placement of machines in retail premises.

As an analogy, if the DOT wants to build a highway, it solicits participation from construction companies. Those companies express an interest and have to be qualified and submit bids for performing the task. The construction companies then may have to purchase trucks, grading equipment, gravel, and concrete, and secure the services of subcontractors in order to carry out the state contract. But the DOT would not be involved in soliciting investment to support the company or the financing to pay for the raw materials, equipment, and services needed.